SECTOR PROGRAM IN SUPPORT OF THE FEDERAL COMMITMENT TO GROWTH AND FISCAL DISCIPLINE

(AR-0280)

EXECUTIVE SUMMARY

Borrower and guarantor:	The Argentine Nation	
Executing agency:	Ministry of Economy, through the Subsecretariat of Provincial Relations of the Secretariat of Finance	
Amount and source:	IDB: (OC)	US$500 million
	Total:	US$500 million
Financial terms and conditions:	Amortization period:	20 years
	Grace period:	5 years
	Disbursement period:	15 months
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	United States dollars from the Single Currency Facility

Objectives: The program is intended to support the Argentine government in achieving fiscal consolidation and in implementing fiscal and structural reforms, in the context of the "financial armor-plating" support package agreed on with the IMF, the Bank and other lending institutions. The specific objective of the program is to support the national and the provincial governments in implementing the accords under the Federal Commitment to Growth and Fiscal Discipline, signed in November 2000.

Description: The program consists of a fast-disbursing sector loan of US$500 million, to be disbursed in two tranches, one of US$255 million and the other of US$245 million, each over an estimated execution period of 15 months. Annex II of the Project Report presents the Matrix of Policy Actions that will condition disbursement of the two tranches. The program contains two components: (1) modernizing and regularizing fiscal administration, and (2) improving intergovernmental relations.

1. Modernizing and regularizing fiscal administration

This component is intended to implement, at the national and provincial levels, a new policy for financial, budgetary and tax management that will be more transparent and programmatic and will be consistent with the goals of fiscal consolidation, including actions to enhance the efficiency of social expenditure management and to introduce rules and standards to underpin greater fiscal discipline in the provinces. The areas of activity and the conditions attaching to this component are as follows:

Fiscal management: The program will facilitate the adoption of policies conducive to greater fiscal discipline on the part of the provincial governments, consistent with the achievement of fiscal balance by 2005. As a condition of the **first tranche**, agreements will enter into force in at least 11 provinces on implementing fiscal accountability laws that make it possible to achieve financial balance by 2005, at the latest, and financial administration laws, consistent in each case with existing national legislation. For the **second tranche**, the program will be conditional upon entry into force of those laws in at least 11 provinces. The expected outcome of these policy measures includes establishment of a legal framework to prevent unsustainable growth in primary spending and provincial public borrowing, and to regulate the use of provincial public resources.

Budgetary programming: The program will support the introduction of new budgetary policies that allow for better programming and monitoring of priorities in the allocation of government funds. As a condition for the **first tranche**, the program will promote the entry into force of an agreement between the national government and the provinces on the adoption of multi-year budgets, covering at least the period 2002-2004. For the **second tranche**, conditions will include the submission of these multi-year budgets to the national Congress and the legislative branches of at least 11 provinces. These measures are expected to result in increased efficiency and transparency in the allocation and utilization of public funds.

Fiscal transparency: The program will seek to introduce policies for enhancing the transparency of financial and fiscal management at both the national and provincial levels, as a means of improving the administration of public funds. The **first tranche** of the program will be conditional upon quarterly publication of federal and consolidated provincial financial and fiscal data on budgetary performance, and project borrowing, with a lag of no more than three months. For the **second tranche**, conditions will relate to release of the above-mentioned data, fully updated to date of disbursement and of the budgetary performance and individual borrowing of at least 13 provinces. These policy actions are expected to institutionalize regular publication of harmonized national and provincial financial and fiscal information as a means for civil society to exert control.

Social expenditure management: The program will support the decentralization of employment and social development programs until now managed by the national government, and the financing of those programs. For the **first tranche**, the program will be conditional upon entry into force of at least 14 agreements for decentralized execution of employment and social development programs, while the **second tranche** will require evidence that additional funds have been transferred during 2001 for execution of those programs in provinces that have signed such agreements. The program will also include as a condition of the **second tranche** the introduction of a single register of beneficiaries for all social programs in at least two provinces. These policy measures are expected to result in more efficient social spending and a substantive improvement in the information available on social programs and their beneficiaries.

Tax administration: The program will facilitate greater and more effective control over taxpayer compliance. The program will include, as a condition for the **first tranche**, the entry into force of contracts for introducing the national tax-revenue collection system (OSIRIS) or a similar system in at least four provincial tax administrations. For the **second tranche**, program conditionality will relate to satisfactory progress in implementing these revenue collection systems in at least 11 provinces. These measures are expected to result in the timely availability of updated information on formal compliance and payment of tax obligations by taxpayers conducting activities in the provinces.

2. Improving intergovernmental relations

This component is intended to help improve intergovernmental relations and facilitate the adoption of policies to simplify and lend greater efficiency and predictability to the distribution of federal revenue-sharing transfers to the provinces. As well, policies will be adopted leading to reform of provincial tax systems and the gradual elimination of distortions in economic activity. As a broader goal, the program will encourage and support the negotiation of policy understandings between the national government and the provinces in the area of modernization of the State. The areas of activity and the conditions attached to this component are as follows:

Revenue-sharing regime: The program will support the adoption of policies to establish new mechanisms for distributing federal revenue-sharing transfers among the provinces. As a condition of the **first tranche**, the program will bring about the entry into force of a pact between the national and provincial governments to give greater predictability to the primary distribution of revenue-sharing transfers, by setting fixed levels for monthly transfers during 2001 and 2002 and establishing minimum monthly transfers for the years 2003, 2004 and 2005, on the basis of moving annual averages. The **first tranche** will also include as a condition the preparation of an action plan (paragraph 2.10) for reforming the revenue-sharing system over the medium term, including aspects relating to institutionalized supervision and control over the new regime, rules and mechanisms for primary and secondary distribution of revenue-sharing transfers, and the establishment of countercyclical mechanisms in the transfer regime. For the **second tranche**, the program will be conditional upon verification of the stipulated monthly transfers, and preparation of draft legislation to reform the revenue-sharing regime, and discussion of this draft with a representative number of provinces. These efforts are expected to result in tangible progress in reforming the revenue-sharing regime, including strengthening and institutionalized supervision of the regime.

Provincial tax reform and harmonization: The program will support strategies for harmonizing provincial taxation systems and minimizing the distortions that certain provincial taxes exert on production. The program's **first tranche** will involve preparation of a framework strategy for minimizing existing distortions in the provinces' productive sectors caused by the current tax systems, and submission of evidence of progress in implementing that strategy. For the **second tranche**, the program will be conditional upon preparation of a draft federal tax harmonization and administration pact, and a plan for implementing it, which will include: reducing the dispersion of tax rates now imposed on items of a similar nature; harmonizing the definition of taxable items and exemptions, and shifting the incidence of the gross-revenue tax to the final stage of a commercial transaction. The program is expected to result in effective implementation of policy measures to minimize the distortionary effects of provincial taxation.

Modernization of the State: The program will support the negotiation of an agreement between the national and provincial governments on policies to encourage the reform of the State. The **first tranche** of the program will seek to achieve consensus between the national and provincial governments on a pact for modernizing the State, in order to achieve greater efficiency in the public sector, deepen the decentralization process, facilitate citizen control over government management, and optimize the quality of public spending. A condition of the **second tranche** will be entry into force of that pact, and presentation of a strategy for implementing it in the following areas: a new model for public management by results; human resources; modernizing government procurement systems; and an institutional structure to spur and monitor the process of modernization. The measures taken under the program are expected to produce conditions and incentives for a joint national-provincial policy approach to modernizing the State.

The Bank's country and sector strategy: The Bank's strategy for Argentina gives priority to the following objectives: (i) sustained growth in output and greater productivity; (ii) poverty reduction and higher living standards; (iii) reform of the State and fiscal equilibrium; and (iv) deepening of regional integration. The proposed program is consistent with that strategy, and will help consolidate public sector reform in the fiscal area and to strengthening the management and transparency of the related public bodies. Specifically, the program will support progress in designing and implementing instruments in support of fiscal federalism, through implementation of the Federal Commitment to Growth and Fiscal Discipline agreed on between the national and provincial governments.

The program is also consistent with the strategy approved by the Board of Executive Directors for the development of subnational governments (document GN-2125), which stresses efforts to create conditions whereby these levels of government can shoulder the responsibilities delegated to them in the process of decentralization, both in terms of public services and economic development infrastructure. To this end, the program will help to establish a context in which the allocation of responsibilities will be accompanied by the required revenue generating mechanisms, thereby making revenues more predictable and establishing a closer correspondence between expenditure and revenue-raising efforts. This will provide incentives for the provinces to adopt consistent measures and give them greater autonomy in designing their fiscal policies.

Environmental and social review: Given the nature of the operation and the policy measures it will support, the program is not expected to have any direct negative environmental impacts. It should have a positive social impact in the impetus it will give to decentralization of employment and social development programs to the provincial level and the transfer of resources for financing them, and in its contribution to greater efficiency in the management of social spending, through improved information on social program beneficiaries.

Benefits: One of the program's principal benefits will be its contribution to modernizing and regularizing fiscal administration in its federal context. On the revenue side, efficient revenue collection systems will be introduced that will provide timely, cross-referenced information on compliance and payment of tax obligations, which will result in higher levels of fiscal revenues. Similarly, on the expenditure side, the program will allow the adoption of modern budgetary management tools that will lend greater efficiency, predictability and transparency to the budget cycle, and this in turn will lead to better allocation, utilization and monitoring of public funds. In addition, the program will help to establish a regulatory framework that will encourage greater fiscal discipline and the achievement of medium-term financial equilibrium.

Another expected benefit of the program will be an improved fiscal framework for national-provincial relations, a key element in achieving and sustaining fiscal balance in Argentina. In this respect, the program will contribute to reforming the revenue-sharing regime and updating the distribution of federal revenue, which in turn will lay the basis for improving living standards in the various provinces. As well, by supporting policies for harmonizing provincial taxation systems, it will help to eliminate tax-induced economic distortions and enhance the competitiveness of the economy. Finally, it will facilitate a joint policy approach between the national and provincial governments to modernizing the State.

The program reflects the Bank's commitment to the “financial armor-plating” support package for Argentina. In this respect, its immediate impact will be to help restore confidence in the country's economy and in its capacity to meet its financial commitments, which should contribute to reducing the country risk and improving credit conditions.

Risks: Some of the anticipated policy actions fall within provincial responsibility, and this introduces an element of risk to program execution that could potentially affect the timing of disbursements by the Bank to the Argentine Nation. To mitigate this risk, the program calls for these actions to be implemented by a representative number of provinces, over which - quite apart from their political willingness to support and implement such actions—the national government will in fact have considerable influence since its financial support for refinancing their short-term debts will be conditioned upon their compliance with fiscal goals and their progress with structural reforms consistent with the policy thrust of the program (paragraph 4.7).

Again, while all provinces that have signed the Federal Pact are expected to support the program fully, the national government has only limited direct influence over the larger provinces. This situation should not undermine the program's impact on those provinces, however, considering that, in the case of the Province of Buenos Aires for example, there is a Fiscal Pact with the national government whereby the province undertakes, among other things, to publish financial and fiscal information and to work towards harmonizing provincial taxation. As well, in addition to the commitment by all signatory provinces to carry out the activities called for under the Federal Commitment to Growth and Fiscal Discipline (which has the status of law), the program will help to lay the foundations for incentives to the larger provinces to adopt substantive fiscal reform measures.

Special contractual clauses: In addition to the standard contractual conditions for disbursement of this sector loan, the disbursement of the **first tranche** will be conditional upon: (i) maintenance of an appropriate macroeconomic policy framework consistent with program objectives and with the country's arrangements with the IMF; (ii) fulfillment of the policy conditions specified in the Matrix of Policy Actions (Annex II); (iii) opening of a special account to receive the proceeds of the loan; and (iv) establishment of the Program Coordinating Unit. Disbursement of the **second tranche** will be conditional upon: (i) maintaining an appropriate macroeconomic policy framework, consistent with program objectives and with the country's arrangements with the IMF; and (ii) satisfying the conditions for the second tranche, as stipulated in the Matrix of Policy Actions.

Compliance with the conditions for each disbursement will be analyzed using the means of verification agreed on with the borrower, as described in the technical documentation for the operation.

Poverty-targeting and social sector classification: This operation does not qualify as a social-equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704).

Exceptions to Bank policy: None

Procurement: Funds from the proposed loan could be used to cover cumulative foreign exchange costs for eligible imports from member countries of the Bank. In this case, Bank procedures for sector loans, which do not require international bidding, would apply.